BEFORE THE PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

DIRECT TESTIMONY

OF

DONALD A. MURRY, Ph.D.

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2007-229-E

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Donald A. Murry. My business address is 5555 North Grand Blvd., Oklahoma City, Oklahoma 73112.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am a Vice President and Economist with C. H. Guernsey & Company, working primarily out of the offices in Oklahoma City and Tallahassee. I am also a Professor Emeritus of Economics on the faculty of the University of Oklahoma.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I have a B.S. in Business Administration and a M.A. and a Ph.D. in Economics from the University of Missouri - Columbia.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND.

A. From 1964 to 1974, I was an Assistant and Associate Professor and

Director of Research on the faculty of the University of Missouri - St. Louis. For the period 1974-98, I was a Professor of Economics at the University of Oklahoma, and since 1998, I have been Professor Emeritus at the University of Oklahoma. Until 1978, I also served as Director of the Center for Economic and Management Research. In each of these positions, I directed and performed academic and applied research projects related to energy and regulatory policy. During this time, I also served on several state and national committees associated with energy policy and regulatory matters and published and presented a number of papers in the field of regulatory economics in the energy industries.

Q. PLEASE DESCRIBE YOUR REGULATORY EXPERIENCE.

A. Since 1964, I have consulted for a number of private and public utilities, state and federal agencies, and other industrial clients regarding energy and regulatory matters in the United States, Canada and other countries. In 1971-72, I served as Chief of the Economic Studies Division, Office of Economics of the Federal Power Commission. From 1978 to early 1981, I was Vice President and Corporate Economist for Stone & Webster Management Consultants, Inc. I am now a Vice President with C. H. Guernsey & Company. In all of these positions I have directed and performed a wide variety of applied research projects and conducted other projects related to regulatory matters. Recently, I have assisted both private

and public companies and government officials in areas related to the regulatory, financial and competitive issues associated with the restructuring of the utility industry in the United States and other countries.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE OR BEEN AN EXPERT WITNESS IN PROCEEDINGS BEFORE REGULATORY BODIES?

A. Yes, I have appeared before the U.S. District Court-Western District of Louisiana, U.S. District Court-Western District of Oklahoma, District Court-Fourth Judicial District of Texas, U.S. Senate Select Committee on Small Business, Federal Power Commission, Federal Energy Regulatory Commission, Interstate Commerce Commission, Alabama Public Service Commission, Alaska Public Utilities Commission, Arkansas Public Service Commission, Colorado Public Utilities Commission, Florida Public Service Commission, Georgia Public Service Commission, Illinois Commerce Commission, Iowa Commerce Commission, Kansas Corporation Commission, Kentucky Public Service Commission, Louisiana Public Service Commission, Maryland Public Service Commission, Mississippi Public Service Commission, Missouri Public Service Commission, Nebraska Public Service Commission, New Mexico Public Service Commission, New York Public Service Commission, Power Authority of the State of New York, Nevada Public Service Commission, North Carolina Utilities Commission, Oklahoma Corporation Commission, South Carolina Public Service Commission, Tennessee Public Service Commission,

Tennessee Regulatory Authority, the Public Utility Commission of Texas, the Railroad Commission of Texas, the State Corporation Commission of Virginia and the Public Service Commission of Wyoming.

Q. WHAT IS THE NATURE OF YOUR TESTIMONY IN THIS CASE?

A. South Carolina Electric & Gas Company, also referred to as "SCE&G" or the "Company," has retained me to analyze its current cost of capital and to recommend a rate of return that is appropriate in this proceeding. SCANA Corporation, a publicly traded company, is the parent company of SCE&G.

II. SUMMARY OF FINDINGS AND RECOMMENDATIONS

Q. PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS IN THIS MATTER.

A. I studied the current economic conditions and the financial markets and determined that continuing increases in inflation and interest rates are important considerations for setting an allowed return for SCE&G for the future. I also reviewed the current capital structure of SCE&G as part of my analysis and considered its appropriateness for developing the total weighted cost of capital in this proceeding. I concluded the appropriate capital structure for SCE&G includes 53.32 percent common stock, 2.42 percent preferred stock and 44.26 percent long-term debt. I determined the

relevant cost of long-term debt was 6.23 percent and preferred stock was 6.41 percent for SCE&G.

I reviewed financial information for SCANA and a group of electric utilities comparable to SCE&G in many key respects. I observed that SCANA was similar in many risk characteristics to these mid-size electric utilities, but, as a holding company whose holdings included SCE&G, it was riskier than the comparable companies due to SCE&G's announced plans to explore adding new nuclear generation.

Next, I estimated the cost of common equity appropriate for this proceeding using the market-based measures for common stock of Discounted Cash Flow, or "DCF," and the Capital Asset Pricing Model, or "CAPM," for the comparable group of electric utilities as proxies for SCE&G. For the comparable companies, the most relevant DCF result was 11.91 percent and the most relevant CAPM results were 12.19 percent and 13.07 percent for the comparable companies.

To reach a recommended allowed return, I evaluated the results of my analysis in the context of the current and forecasted economic environment, and I am recommending an allowed return in the range of 11.75 percent to 12.00 percent. My recommended total cost of capital range is 9.18 percent to 9.31 percent.

Finally, to verify that my recommended allowed return was sufficient to attract and maintain capital, I compared the After-Tax Interest Coverage at the low end of my recommended return level to the After-Tax Interest Coverage of the comparable electric utilities. As this fell at the upper end of the range of coverages of the comparable group, my recommended range of returns is sufficient to attract and maintain capital in current markets.

III. METHODOLOGY

Q. PLEASE EXPLAIN THE STEPS THAT YOU FOLLOWED AS YOU DEVELOPED YOUR ANALYSIS AND RECOMMENDATION.

A. As a background to my analysis of the cost of capital of SCE&G, I reviewed the current economic environment. Notably, the current economic statistics reveal increasing inflationary pressures and rising interest rates, and analysts' forecasts anticipate continuing increases. I also reviewed the published financial characteristics of SCANA, which included studying measures of financial and business risks and recent returns.

I identified the appropriate capital structure for SCE&G in this proceeding. I also identified the costs of long-term debt and preferred stock. Then I measured the cost of common equity for SCE&G.

To measure the cost of common equity for SCE&G, I used the commonly accepted DCF method and CAPM. I applied these market-based measures to SCANA, using SCANA market data, and I applied this analysis for comparison to the group of electric utilities with similar financial characteristics to SCE&G. I reviewed the SCANA market-based cost of capital, which recognizes that SCANA raises capital for SCE&G. This methodology produces a reasonable estimate of the cost of common equity for SCE&G. Finally, I tested these levels of common stock returns to verify that they would produce sufficient funds to cover the fixed interest debt costs and to attract capital.

Q. WHEN SELECTING A GROUP OF COMPARABLE COMPANIES FOR ANALYSIS, WHAT CRITERIA DID YOU USE?

A. First, I identified the electric utility companies reported by *Value Line* to select a group of comparable companies. *Value Line* provides a common data source for analysis of publicly traded electric utility companies. *Value Line* does not underwrite securities and does not have a conflict of interest that some critics associate with certain companies that provide financial information. It is also readily available to a broad community of investors. I then excluded all companies actively involved in a merger from the group of comparable companies. A utility involved in a merger is an unreliable proxy for measuring the cost of capital of a

regulated utility such as SCE&G. Next, I selected firms that have not reduced or eliminated their dividend in the past five years. Companies that have failed to maintain dividends are likely to be under some financial stress, and they would not provide a good standard by which to set an allowed return to maintain a healthy utility. Fourth, I removed those utilities for which *Value Line* is forecasting zero or negative earnings growth. Again, this criterion will help assure that my analysis focuses on healthy utilities. Fifth, I narrowed the group by focusing on companies that have market capitalization greater than $2 billion and less than $8 billion. Size affects the market cost of capital, and this criterion selects companies of similar size to SCE&G. Last, I omitted those companies that earn less than 60 percent of their operating income from electric utility operations.

Q. AFTER APPLYING THESE CRITERIA TO UTILITIES TRADED IN THE MARKET, WHICH UTILITIES DID YOU SELECT AS COMPARABLE TO SCE&G FOR YOUR ANALYSIS?

A. The selected utilities are DPL, Northeast Utilities, Nstar, OGE Energy, Pepco Holdings, Pinnacle West and Wisconsin Energy.

Q. ARE YOU SPONSORING ANY EXHIBITS WITH YOUR TESTIMONY?

A. Yes. I am sponsoring Exhibit No. ____ (DAM-1) through Exhibit

No. ____ (DAM-26), all of which were prepared under my direct supervision.

IV. ECONOMIC ENVIRONMENT

Q. CAN YOU SUMMARIZE THE CURRENT ECONOMIC ENVIRONMENT?

A. Growth in real GDP slowed to a revised 0.6 percent annual rate in the first quarter of 2007 according to a report issued by the Commerce Department on May 31st; however, in general the economic statistics reflect a healthy economy. *Blue Chip Financial Forecasts ("Blue Chip")*, a highly regarded publication of consensus forecasts, predicts growth in real Gross Domestic Product ("GDP") will increase to 2.3 percent in the second quarter of 2007 and improve to a 3.0 percent rate in the first through third quarters of 2008 as shown in Exhibit No. ____ (DAM-1). The economy added 157,000 jobs in May, and on June 1st, the Labor Department reported that the unemployment rate remained at 4.5 percent. According to that report, many businesses are having difficulty recruiting professional and skilled workers. Business activity is expanding; for example, the National Association of Purchasing Management-Chicago business barometer increased to 61.7 in May from 52.9 in April. A measure greater than 50 signals expansion. Non-defense capital goods shipments, excluding aircraft,

grew in February, March, and April, and forecasters predict capital expenditures will grow in the five percent to six percent range in the second quarter.

The housing market remains soft, however the Commerce Department reported that new home sales rose 16 percent in April. Analysts attributed the increase in sales to lower prices. Most significantly, however, analysts expect the growing economy to put upward pressure on both inflation and interest rates.

Q. WHAT ARE SOME OF THE CONSEQUENCES OF THIS ECONOMIC GROWTH?

A. Increased manufacturing activity, spurred by economic growth abroad and increasing exports, should keep labor markets tight. Many forecasters predict low unemployment will offset negative consumer confidence associated with the housing slump and the decline in home prices. The unemployment rate of 4.5 percent is close to the five-year low of 4.4 percent reached in March of this year. Treasury yields have increased to the highest rate in three years. The yield curve of Treasury debt has recently returned to its normal shape; that is, the yields on long-term United States Treasury bonds now exceed the yields on short-term Treasury bills.

The consensus is that overall economic activity will improve into 2008 as slow residential investment picks up, capital spending improves

and relatively high core inflation keeps the Federal Open Market Committee ("FOMC") from lowering rates throughout 2007. As reported by *Bloomberg* on June 4th, options on Federal Fund futures at the Chicago Board of Trade indicate an approximate 40 percent chance the central bank will lift its target rate for overnight loans between banks to 5.5 percent from the current 5.25 percent.

Q. YOU MENTIONED THAT THE INFLATION RATE IS IMPORTANT TO INVESTORS. WHAT ARE CURRENT INFLATION CONSIDERATIONS?

A. Economists have consistently underestimated inflationary pressures over the last two years. Sharp increases in food and energy prices so far in 2007 have led to high near-term increases in inflation forecasts. Analysts expect the Consumer Price Index ("CPI") to increase at a 4.2 percent annualized rate in the second quarter of 2007 following a 3.8 percent annualized rate of growth in the first quarter. The core CPI, which excludes food and energy, slowed somewhat in the second quarter from the 2.3 percent rate experienced in the first quarter. However, the consensus is that core inflation will increase at a 2.3 percent rate on a December-over-December basis for 2007 and 2008. This is near the top of the FOMC's presumed informal target range of 1.5 percent to 2.5 percent for the core CPI, which implies that the Federal Reserve could move to tighten credit.

In confirmation of the relative importance of these developments, the minutes from the May 9th FOMC meeting state,

> In these circumstances, the Committee's predominate policy concern remains the risk that inflation will fail to moderate as expected. Future policy adjustments will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.

Q. HOW HAVE THE ECONOMIC ACTIVITY AND INFLATION EXPECTATIONS AFFECTED INTEREST RATES?

A. The FOMC raised interest rates 17 times between June 2004 and June 2006. Although the FOMC recently has foregone raising short-term rates further, it has indicated that it will remain vigilant regarding inflation concerns. For example, Richmond Federal Reserve Bank President Jeff Lacker recently said, "inflation expectations seem to have risen as inflation has risen, and seem to be lodged around 2 percent, (this) gives me a lot of concern."

Q. YOU DISCUSSED SOME FACTORS CURRENTLY AFFECTING INTEREST RATES. WHAT ARE THE RECENT AND CURRENT LEVELS OF BOND RATES?

A. Currently, the 10-year Treasury and Baa-corporate bond rate are about 5.22 percent and 6.38 percent, respectively. As shown on Exhibit No. ____ (DAM-2), according to the Federal Reserve, the yields on 10-year Treasury notes bottomed in 2003 and have been increasing ever since.

Q. WHAT IS THE FORECASTED LEVEL OF BOND INTEREST RATES?

A. Generally, analysts expect long-term bond rates to continue rising. *Blue Chip* forecasts the Baa-corporate rate will continue to increase reaching 6.8 percent in 2008 as illustrated in Exhibit No. ____ (DAM-3), pages 1 and 2. The current yield on 30-Year Treasury bonds now exceeds the *Blue Chip* forecasts. *Value Line* provides a longer-term forecast for the 2010-12 period and also shows interest rate increases out to that period. I have shown this continued forecasted growth in interest rates in Exhibit No. ____ (DAM-4), pages 1 and 2.

Q. HOW IMPORTANT IS THIS ECONOMIC ACTIVITY TO YOUR RECOMMENDATION IN THIS PROCEEDING?

A. The rates set in this proceeding are likely to be in effect during a period of rising inflation and interest rates, and this is an important background for my analysis. Rising inflation and interest rates erode earnings and adversely affect the cost of a utility's debt and equity. Utilities such as SCE&G are particularly sensitive to the effects of inflation and increasing interest rates because they are capital intensive with large interest payment obligations. The rising costs erode utility margins. That is, inflation and rising interest rates increase the risk that common stockholders will not achieve their anticipated returns on investment.

V. ALLOWED RETURN OBJECTIVE

Q. WHAT IS THE PRINCIPAL OBJECTIVE IN YOUR TESTIMONY REGARDING SETTING THE ALLOWED RETURN IN THIS PROCEEDING?

A. The principal objective was to determine an allowed return for SCE&G in this proceeding that is consistent with the concept of a fair rate of return on invested capital. The analysis performed accomplished this objective.

Q. WHAT DO YOU MEAN BY THE TERM "FAIR RATE OF RETURN?"

A. By the term "fair rate of return," I am referring to a return that meets the standards set by the United States Supreme Court decision in *Bluefield Water Works and Improvement Company vs. Public Service Commission, 262 U.S. 679 (1923) ("Bluefield")*, as further modified in *Federal Power Commission vs. Hope Natural Gas Company, 320 U.S. 591 (1944) ("Hope")*. As an economist, I believe that a rate of return is fair if it provides earnings to investors similar to returns on alternative investments in companies of equivalent risk. Such a return will be sufficient to enable SCE&G to compensate investors for assumed risk, attract capital, operate successfully, and maintain its financial integrity. This standard implies that utilities typically do not face the same market influences as more

competitive markets, and a single supplier is likely to exist in a market because of economies of scale in providing retail service. This is the common economic rationale for regulation.

VI. CAPITAL STRUCTURE

Q. WHAT IS THE APPROPRIATE CAPITAL STRUCTURE OF SCE&G IN THIS PROCEEDING?

A. I determined that the appropriate capital structure for SCE&G in this proceeding is the capital structure as of March 31, 2007 with a total capital of $4,736,784,886. This capital structure includes long-term debt of $2,096,488,400 or 44.26 percent of total capital, preferred stock of $114,558,800 or 2.42 percent and common equity of $2,525,737,686 or 53.32 percent. This capital structure includes a planned long-term issuance scheduled in 2008. I have illustrated this capital structure in Exhibit No. ____ (DAM-5).

Q. HOW DOES THIS CAPITAL STRUCTURE OF SCE&G COMPARE TO THE CAPITAL STRUCTURE OF OTHER ELECTRIC UTILITIES?

A. SCE&G's common equity ratio is at the upper end of similar ratios for the comparable electric utilities that I studied. Nevertheless, SCE&G's common equity ratio included in its application for increased rates is within the bounds of reasonableness for an electric utility in today's market.

VII. COST OF LONG-TERM DEBT AND PREFERRED STOCK

Q. WHAT IS THE APPROPRIATE COST OF LONG-TERM DEBT FOR USE IN THIS PROCEEDING?

A. As shown in Exhibit No. ____ (DAM-6), SCE&G's embedded cost of long-term debt is 6.23 percent.

Q. WHAT IS THE APPROPRIATE COST OF PREFERRED STOCK IN THIS PROCEEDING?

A. SCE&G's cost of preferred stock is 6.41 percent. I have shown the calculation of the embedded cost of preferred stock in Exhibit No. ____ (DAM-7).

VIII. FINANCIAL RISK

Q. YOU USED THE TERM "FINANCIAL RISK." WHAT DID YOU MEAN BY THAT TERM?

A. Because the payment of interest on debt and the dividends on preferred stock receive priority over returns to common stock, common stock investors incur the risk that funds will not be sufficient to meet their investment expectations. Because of the prior claims of debt and preferred stock instruments, investors may not realize their anticipated returns in dividends and capital appreciation, and this is a form of financial risk.

Q. DID YOU ASSESS SCE&G'S FINANCIAL RISK?

A. Yes, as I noted previously, the common stock equity ratio of SCE&G is slightly higher than the similar ratio for the comparable companies. Consequently, the financial risk of SCE&G is similar to or slightly less than that of the average of the comparable electric utilities.

IX. BUSINESS RISK

Q. YOU ALSO USED THE TERM "BUSINESS RISK." WHAT DID YOU MEAN BY THAT TERM?

A. As I have used the term in the context of my analysis, "business risk" is the exposure to investors' anticipated returns because of the uncertainties of a company's day-to-day business activities. Business risks to electric utilities include such factors as the risk of recovering fuel cost increases, storm damage expenses and increased operating and maintenance expenses among other influences. I reviewed measures of business risk for the comparable companies. Financial publications address the specific risks of SCANA, the parent company of SCE&G, so I reviewed the financial information describing SCANA's financial circumstances.

Q. DOES SCE&G HAVE ANY SPECIAL RISKS TO CONSIDER?

A. Yes. SCE&G plans to invest in a new nuclear unit in the next few years. In today's financial market, nuclear power carries special risk. Because no investor owned utility in the United States has built a new nuclear unit in decades, new technology is still in the development stage. Also, nuclear units entail sizable capital investment. While current public policy considerations are supportive of nuclear power, public policy is never static and potential adverse changes in this policy are a risk to investors. Moreover, although nuclear units have been in operation in the United States and other countries for many years, investors have reservations about the associated risks including the recovery of the investment and operating costs over the life of the plants. This is an important form of regulatory risk.

Q. YOU STATED THAT YOU REVIEWED INFORMATION DESCRIBING SCANA'S FINANCIAL CIRCUMSTANCES. WHAT MEASURES OF BUSINESS RISK OF SCANA DID YOU REVIEW?

A. Because they are readily available to investors, I reviewed bond ratings and the *Value Line* rankings of "Safety" and "Timeliness." Business risk affects all of these measures although financial risk and other factors affect them as well. *Value Line* defines its "Safety" ranking as a measure of potential risk associated with individual common stocks and "Timeliness"

as a measure of a stock's probable performance in the forthcoming year relative to the overall market. As I illustrate in Exhibit No. ____ (DAM-8), *Value Line*, ranks SCANA a "2" (with "1" being the highest) for Safety. This ranking is similar to the rankings of the comparable electric utilities. *Value Line* ranks SCANA a "5" for Timeliness, which is the lowest category. This means that *Value Line* believes that the market will outperform SCANA's common stock over the next year.

Q. YOU ALSO SAID THAT YOU REVIEWED THE BOND AND CREDIT RATINGS OF SCANA AND THE COMPARABLE ELECTRIC UTILITIES. WHAT DID THIS COMPARISON SHOW?

A. As Exhibit No. ____ (DAM-9) shows, SCANA presently has a *Value Line* "Financial Strength" rating of A-, a Standard & Poor's credit rating of A and a S&P "Business Position" of 4. Each is slightly better than the average of the comparable electric utilities.

X. FINANCIAL STATISTICS

Q. YOU STATED THAT YOU REVIEWED SOME FINANCIAL STATISTICS OF THE COMPARABLE COMPANIES AND SCANA. WHAT DID YOUR REVIEW OF THESE STATISTICS REVEAL?

A. In general, these financial statistics confirmed that SCANA is very similar in many respects to the comparable electric utilities. For example,

as I illustrated in Exhibit No. ____ (DAM-10), *Value Line* predicts currently that SCANA will experience a return on common equity in 2007 of about 11.0 percent, although SCE&G itself only earned 8.27 percent on common equity during the test year. While SCANA's projected return is less than the comparable company average, an abnormally high estimated return for DPL influences the comparable company average. As I show in Exhibit No. ____ (DAM-11), the dividend growth rate of SCANA is similar to that of the comparable companies. Similarly, SCANA has maintained a dividend payout ratio similar to the comparable companies as illustrated in Exhibit No. ____ (DAM-12). With these similar financial statistics, not surprisingly, as Exhibit No. ____ (DAM-13) shows, SCANA's market valuation is similar to the comparable electric utilities, as reflected in the market price-earnings ratios.

Q. DID YOU COMPARE SCE&G'S RETURN ON COMMON EQUITY TO ANY BROADER GROUP OF ELECTRIC UTILITIES?

A. Yes. I reviewed the composite return on common equity as reported by *Value Line.* In its June 29 report, *Value Line* reported an estimated composite return on common equity for 2007 for the electric utility industry of 14.2 percent. This is an increase in the composite over 2006, which was 12.4 percent.

XI. COST OF COMMON STOCK EQUITY

Q. YOU STATED PREVIOUSLY THAT YOU CALCULATED THE COST OF COMMON EQUITY FOR SCE&G. WHAT METHODS DID YOU USE?

A. I employed two generally accepted market-based methods for estimating the cost of common equity in regulatory proceedings. These are the Discounted Cash Flow analysis, which is probably the most commonly referenced method in regulatory proceedings, and the Capital Asset Pricing Model. I applied each of these methods to estimate the cost of common equity of SCANA and each of the comparable electric utilities, and from the results yielded by this analysis, then estimated the cost of capital for SCE&G which is not publicly traded.

Q. WHEN YOU INTERPRETED THE DCF AND CAPM RESULTS, WHAT DID YOU DO TO PUT THEM INTO AN APPROPRIATE CONTEXT?

A. When interpreting the DCF and CAPM results, I took into account the underlying assumptions of these two methods. I also considered their analytical strengths and weaknesses, especially when used to assist in the development of the cost of capital in a ratemaking proceeding.

Q. HOW DID YOU APPLY THESE METHODS TO REACH A RECOMMENDED ALLOWED RETURN IN THIS PROCEEDING?

A. Analysts do not report the financial measures that apply specifically to SCE&G because it is a wholly-owned subsidiary of SCANA. Additionally, I interpreted these results in the context of current market conditions and other factors that I studied. From this analysis I then determined my recommendation for a fair and reasonable allowed return in this case.

Q. HOW DID YOUR STUDY OF CURRENT ECONOMIC CONDITIONS INFLUENCE YOUR INTERPRETATION OF YOUR DCF FINDINGS?

A. As I noted, the forecasted rising inflation and interest rates will affect the cost of common equity for SCE&G. The general level of interest rates is an indicator of returns available from alternative investments that rational investors consider when making investment decisions.

XII. DISCOUNTED CASH FLOW METHOD

Q. PLEASE DEFINE THE DCF METHODOLOGY FOR MEASURING THE COST OF COMMON EQUITY.

A. The following formula expresses the DCF calculation of an investor's required rate of return:

$$K = D/P + g$$

Where:

K	=	cost of common equity
D	=	dividend per share
P	=	price per share and
g	=	rate of growth of dividends, or alternatively, common stock earnings.

In this expression, "K" is the capitalization rate required to convert the stream of future returns into a current value. "D" is the expected level of dividends paid to the common stock holders. "P" is the valuation of the common stock by the investors reflected by recent market prices. Consequently, the ratio "D/P" is the expected dividend yield on an investment in a company's common stock. The "g" is the growth rate in returns anticipated by the investor.

Q. YOU MENTIONED THE UNDERLYING ASSUMPTIONS OF THE COST OF CAPITAL MODELS. WHAT ASSUMPTIONS UNDERLYING THE DCF METHOD ARE IMPORTANT WHEN ESTIMATING THE COST OF COMMON EQUITY IN PRACTICE?

A. I believe one can identify the following important underlying assumptions associated with the basic annually compounded DCF model:

1. Investors are risk averse. That is, for a given return, investors will seek the alternative with the lowest amount of risk. In other words, the greater the risk that investors attribute to a given investment, the greater the return they require from that investment.

2. The discount rate must exceed the growth rate, i.e., K, in the stated expression, must exceed g. The mathematics associated

with the derivation of the basic annually compounded DCF model requires this assumption.

3. The payout and the price earnings ratios remain constant.

4. Expected cash flows consist of dividends and the future sales price of the stock. The sales price in any period will equal the present value of the dividends and the sales price expected after that period including any liquidating dividend. Consequently, the sales price in any period is equal to the present value of all expected future dividends.

5. Dividends are paid annually.

6. There is no external financing.

As noted in these assumptions, expected cash flows consist of dividends and the future sales price of common equity, but actually, earnings drive both.

XIII. STRENGTHS OF THE DCF

Q. YOU INDICATED THAT YOU NOTED THE STRENGTHS OF THE DCF METHOD. WHAT, IN YOUR OPINION, ARE ITS STRENGTHS?

A. The DCF is the most common method that one encounters for measuring the cost of common equity in regulatory proceedings. Its familiarity to persons in a regulatory setting is an important strength. A second important feature is that it is theoretically sound. Additionally, as a market-based measure of the cost of capital, its results change as the market

environment surrounding a company's securities change. That is, it recognizes investors' expectations, and it uses market price information, as well as a company's dividend and earnings performance, to determine the value that an investor places on anticipated returns. Using these market relationships, an analyst can estimate the opportunity cost of an investor's funds, which is the cost of common equity.

XIV. WEAKNESSES OF THE DCF

Q. WHAT DO YOU SEE AS IMPORTANT WEAKNESSES OF THE DCF METHOD?

A. The DCF has both conceptual and data issues that may lead to misinterpretation of the calculated results. Either can create problems in a ratemaking proceeding.

Q. WHAT DID YOU MEAN WHEN YOU SAID THAT CONCEPTUAL PROBLEMS OF THE DCF METHOD COULD LEAD TO MISINTERPRETATION OF THE CALCULATED RESULTS?

A. For example, a significant problem with the DCF method, when used in regulation to set an allowed return, is that it estimates the marginal cost of common equity of a company, not the average cost of common equity. That is, the DCF provides an estimate of the minimal return

necessary to attract marginal, or incremental, investment in the common equity.

Q. IN YOUR OPINION, IS THE MARGINAL COST NATURE OF THE DCF IMPORTANT?

A. Yes. Analysts interpreting the results of the DCF calculations may not recognize their context or what they truly represent. Consequently, the DCF-based calculations may be misleading. For example, the DCF calculated cost of common equity result does not provide any cushion in the estimation of the cost of capital. When using these results as a basis for a recommended allowed return in a regulatory proceeding, the basic calculations may not provide a regulated company a reasonable opportunity to earn its allowed return. In fact, this misunderstanding of the DCF results can virtually assure that a regulated company will not have the opportunity to earn its allowed return.

Q. IN YOUR EXPERIENCE, HAVE REGULATORS OR ANALYSTS RECOGNIZED THAT THE DCF RESULTS MAY NOT ALLOW A UTILITY SUFFICIENT LATITUDE TO EARN ITS ALLOWED RETURN?

A. Yes. Regulators and analysts often adjust results of a DCF estimate for factors not reflected in the marginal cost estimate. A flotation cost adjustment is very common by analysts and regulators, for example. The

flotation adjustment specifically recognizes that the market-based DCF estimate of the cost of capital does not necessarily account for the costs of common stock issuance. These issuance costs are inescapable costs that include legal and investment banker fees and costs of publishing a prospectus. As a market measure of the cost of outstanding securities, the DCF cannot incorporate issuance costs for new securities into the measured cost.

Q. DO ANALYSTS RECOGNIZE THIS PROBLEM OF ISSUING LARGE BLOCKS OF SECURITIES?

A. Yes. Some analysts specifically apply an adjustment for "market pressure" associated with the sale, or relative increase in the supply of a particular security relative to the current demand for that security.

Q. RECOGNIZING THE MARGINAL COST NATURE OF THE DCF AND THE NEED FOR A REGULATED UTILITY TO BE IN THE FINANCIAL MARKETS, DO YOU RECOMMEND CALCULATING A FLOTATION ADJUSTMENT OR AN ADJUSTMENT FOR MARKET PRESSURE?

A. No, I do not. Instead, however, I believe that focusing on the higher DCF results is an appropriate compensation for the nature of the DCF calculation in most instances. I believe that the DCF results fall within the distribution of estimated cost of common equity that investors are likely to

perceive. This also provides market measured estimates of the cost of such factors as flotation costs and other market effects. This, in my opinion, directly recognizes the marginal cost nature of the DCF method.

Q. YOU MENTIONED THAT REGULATORS HAVE RECOGNIZED THESE LIMITATIONS OF THE DCF METHOD. PLEASE EXPLAIN HOW SOME REGULATORS HAVE RECOGNIZED THESE LIMITATIONS OF THE DCF.

A. As I noted previously, some regulatory bodies routinely apply flotation adjustments. I have also observed that some regulators have applied those adjustments under certain circumstances. For example, an Indiana commission decision in 1990 specifically addressed the marginal cost nature of the DCF. The commission noted that the assumptions underlying the DCF model rarely, if ever, hold.[1] The commission stated that an "...unadjusted DCF result is almost always well below what any informed financial analyst would regard as defensible and therefore requires an upward adjustment based largely on the expert witness' judgment."[2]

XV. DATA USED IN DCF ANALYSIS

Q. YOU MENTIONED PROBLEMS ASSOCIATED WITH THE DATA AVAILABLE TO ANALYSTS FOR A DCF ANALYSIS. WHAT

[1] Phillips, Charles F., Jr. and Robert G. Brown, *Chapter 9: The Rate of Return,* The Regulation of Public Utilities: Theory and Practice, (1993: Public Utility Reports, Arlington, VA) p. 423.
[2] *In re Indiana Michigan Power Company,* 116 PUR4th 1, 17 (Ind. 1990).

GROWTH RATE DATA DID YOU PRIMARILY USE IN YOUR DCF ANALYSIS?

A. I used forecasted earnings growth estimates as the primary measure in my DCF analysis. Forecasts of common stock earnings capture investors' expectations about future returns, and these are the expectations that affect their decisions to invest. This conclusion is consistent with the findings in the financial academic literature.

Q. YOU MENTIONED FINDINGS IN THE ACADEMIC LITERATURE. HAVE ANALYSTS PERFORMED STUDIES REGARDING WHICH DATA USED IN A DCF ANALYSIS ARE MOST LIKELY TO CAPTURE INVESTORS' EXPECTATIONS ABOUT FUTURE RETURNS?

A. Yes. As early as 1982, academic studies showed that analysts' forecasts were superior to historical, trended growth rates for DCF analyses.

Q. PLEASE EXPLAIN SOME OF THE STUDIES THAT DEMONSTRATED THAT INVESTORS LOOK TO ANALYSTS' FORECASTS WHEN MAKING INVESTMENT DECISIONS.

A. A number of authors have addressed the merits of analysts' forecasts in a DCF analysis of the cost of capital. For example, a well-known financial textbook by Brigham and Gapenski explains why analysts' growth

rate forecasts are the best source for growth measures in a DCF analysis. They state:

> Analysts' growth rate forecasts are usually for five years into the future, and the rates provided represent the average growth rate over the five-year horizon. Studies have shown that analysts' forecasts represent the best source for growth for DCF cost of capital estimates.[3]

Research reported in the academic literature supports this position. For example, Vander Weide and Carleton found:

> ...overwhelming evidence that the consensus analysts' forecast of future growth is superior to historically oriented growth measures in predicting the firm's stock price....Our results are consistent with the hypothesis that investors use analysts' forecasts, rather than historically oriented growth calculations, in making stock buy-and-sell decisions.[4]

Q. HAVE ANY OF THE ACADEMIC STUDIES APPLIED SPECIFICALLY TO THE DCF GROWTH RATES USED IN REGULATORY PROCEEDINGS?

A. Yes. Timme and Eisemann examined the effectiveness of using analysts' forecasts rather than historical growth rates for determining investors' expectations in rate proceedings. They concluded:

> The results show that all financial analysts' forecasts contain a significant amount of information used by investors in the determination of share prices not found in the historical growth rate....The results provide additional evidence that the historical

[3] Brigham, Eugene F., Louis C. Gapenski, and Michael C. Ehrhardt, "Chapter 10: The Cost of Capital," Financial Management Theory and Practice, Ninth Edition (1999: Harcourt Asia, Singapore), p. 381.
[4] Vander Weide, James H. and Willard T. Carleton, "Investor Growth Expectations: Analysts vs. History," *The Journal of Portfolio Management,* Spring 1988, pp. 78-82.

> growth rates are poor proxies for investor expectations; hence they should not be used to estimate utilities' cost of capital.[5]

More broadly, Gordon, Gordon and Gould found:

> ...the superior performance by KFRG (forecasts of growth by security analysts) should come as no surprise. All four estimates of growth rely upon past data, but in the case of KFRG a larger body of past data is used, filtered through a group of security analysts who adjust for abnormalities that are not considered relevant for future growth.[6]

Q. DO YOU FIND THESE STATEMENTS BY THESE AUTHORS CREDIBLE?

A. Yes. These results are not surprising because investors, when contemplating an investment in a common stock, very frequently review reputable analysts' forecasts. Such information available to them at the time they contemplate investing will influence their decision to invest.

Q. ARE YOU AWARE OF ANY OTHER EMPIRICAL INFORMATION THAT FOCUSES ON THE IMPORTANCE OF COMMON STOCK EARNINGS?

A. Yes. In an "event analysis" a colleague and I compared the market reactions of announced dividends and common stock earnings that were likely to be a surprise to the market. We compared the market reactions to dividend announcements with the reactions to common stock earnings

[5] Timme, Stephen G. and Peter C. Eisemann, "On the Use of Consensus Forecasts of Growth in the Constant Growth Model: The Case of Electric Utilities," *Financial Management*, Winter 1989, pp. 23-35.
[6] Gordon, David A., Myron J. Gordon, and Lawrence I. Gould, "Choice among methods of estimating share yield," *Journal of Portfolio Management;* Spring 1989, Volume 15, Number 3, pages 50-55.

announcements. Specifically, we looked at the price impact of nineteen earnings announcements and eight dividend announcements that exceeded *Value Line's* projected levels during a period from 2001 to 2003.

Q. DID YOU DISTINGUISH THE ORDINARY MARKET MOVEMENTS FROM INVESTORS' RESPONSES TO THE DIVIDEND AND COMMON STOCK EARNINGS ANNOUNCEMENTS?

A. Yes, we used ratios of a utility's common stock price to the Dow Jones Utility Index as a benchmark. The Dow Jones Utility Index provided a measure of the market values of utility common stocks that did not embody the influence of the common stock and earnings per share announcement. This comparison isolated the impact of the surprise dividend and earnings announcements.

Q. WHAT WERE THE RESULTS OF THIS ANALYSIS?

A. The analysis clearly showed significant price impact on a utility's common stock of surprise earnings announcements relative to surprise dividend announcements. In Exhibit No. ____ (DAM-14), I illustrate the percentage increase in the market price relative to the utility index for both the unexpected earnings per share and the dividend announcements. In this chart, the relative impact of the unexpected earnings per share surprise

announcement in these cases, when compared to the dividend announcement, is substantially greater.

Q. IN DEVELOPING YOUR DCF ANALYSIS, YOU REVIEWED COMMON EQUITY EARNINGS. WHAT DID THIS REVIEW SHOW?

A. For a historical perspective, I reviewed the common equity earnings and dividend history of the companies studied. However, as I stated, I focused my analysis principally on forecasted common stock earnings. This review showed SCANA's historical earnings growth has been higher than most of the comparable electric utilities; however, according to *Value Line's* forecasts this will reverse in the next several years. I show this comparison in Exhibit No. ____ (DAM-15).

Q. YOU INCLUDED BOOK VALUE GROWTH RATES IN THIS SCHEDULE, BUT YOU FOCUSED ON COMMON STOCK EARNINGS AND DIVIDEND GROWTH. DO YOU BELIEVE THAT BOOK VALUE GROWTH RATES ARE IMPORTANT TO INVESTORS?

A. No. The growth in book value of a common stock does not directly influence the market value of a utility's common stock earnings and the dividends paid. The underlying book value of a common stock is important

during a company's liquidation; however, this is not as important when valuing a successfully operating electric utility.

Q. WHAT WAS THE SOURCE OR SOURCES OF THE COMMON STOCK PRICE DATA THAT YOU USED IN YOUR DCF ANALYSIS?

A. From *YAHOO!* Finance, I obtained current prices for a recent two-week period and high and low share prices during the past 52-week period. *YAHOO!* Finance is a widely-used internet portal that provides electronic financial information including daily prices. Of course, I was investigating current market prices because they reflect both current market conditions and investor expectations.

XVI. DCF CALCULATIONS

Q. WHAT WERE THE RESULTS OF YOUR DCF CALCULATIONS?

A. As I described earlier, the financial literature supports the use of common equity forecasts in DCF calculations. Using these estimates for the electric utilities comparable to SCE&G, the range of DCF returns for the mid-size utilities is 9.51 percent to 15.00 percent using the 52-week price ranges. The average for this group of electric utilities is 11.91 percent. This is the most relevant DCF calculation for setting an allowed return in the current market. Using current prices resulted in an average DCF of 10.89

percent. I have illustrated these estimates in Exhibit No. ____ (DAM-16) and Exhibit No. ____ (DAM-17).

In comparison, the combined historical and forecasted dividend growth rates and the common stock prices for the past year produced inordinately low estimates for both SCANA and the comparable companies. I show the results of this DCF calculation in Exhibit No. ____ (DAM-18). These results average from 8.65 percent to 9.85 percent. This is too close to the current yield of preferred stock of an A- rated utility, which is 7.29 percent, especially given the recent and forecasted increases in interest rates. By using current prices and dividend growth rates in my DCF analysis, the resulting estimates of the cost of common equity vary from a low estimate of 5.30 percent for OGE Energy to a high for PEPCO Holdings of 14.52 percent. Exhibit No. ____ (DAM-19) illustrates this comparison. Using the wide-ranging historical earnings growth rates combined with forecasted growth rates resulted in equally wide-ranging results when I used both 52-week prices and current prices in this analysis. I showed these results in Exhibit No. ____ (DAM-20) and Exhibit No. ____ (DAM-21). My DCF calculations, based on both the historical and forecasted earnings per share growth rates, fail to produce meaningful results. These results are examples of the difficulties when using the DCF analysis in some markets, as I discussed previously.

XVII. CAPITAL ASSET PRICING MODEL

Q. YOU STATED THAT YOU USED THE CAPITAL ASSET PRICING MODEL IN YOUR ANALYSIS. PLEASE EXPLAIN THE CAPITAL ASSET PRICING MODEL.

A. The Capital Asset Pricing Model, or CAPM, is a risk premium method. It measures the risk differential, or premium, between a given investment and the market as a whole. It recognizes an investor's ability to diversify his portfolio by combining securities of various risks, and, through diversification, reducing the investor's total risk. However, some risk is non-diversifiable, e.g., market risk, and investors remain exposed to that risk. The theoretical expression of the CAPM model is:

$$K = R_F + \beta (R_M - R_F)$$

Where:

K	=	the required return
R_F	=	the risk free rate
R_M	=	the required overall market return and
β	=	beta, a measure of a given security's risk relative to that of the overall market.

To elaborate on these definitions, the risk free rate is the known benchmark rate of a particular security. Analysts may use a variety of rates, such as rates of Treasury securities and corporate bonds, for this benchmark rate. The overall market return is the return on all of the investment alternatives available to the investor that investors may combine into a portfolio. The beta represents the relative volatility of the analyzed security to the market

return. In this above expression, the value of market risk is the differential between the market return and the "risk-free" rate. By estimating the risk differential between an individual security and the market as a whole, an analyst can measure the relative cost of that security compared to the market as a whole.

Q. HOW DID YOU USE THE CAPM IN YOUR ANALYSIS?

A. As a risk premium based technique, the CAPM provides a longer-term perspective than that of the more volatile DCF. I used it as a stable benchmark of the reasonable cost of common stock of the studied companies. It takes current debt costs as a basis and estimates the cost of a common stock based on the risk differential between the two. The CAPM links the incremental cost of capital of an individual company with the risk differential between that company and the market as a whole. This is a rather imprecise method, but it is a good tool for assessing the general level of the cost of a security.

Q. WHAT ARE THE BENEFITS THAT YOU SEE IN USING THE CAPM IN A REGULATORY PROCEEDING?

A. The CAPM, as a risk premium method, is a relatively stable measure of the cost of capital. The results of the CAPM are not likely to vary much over time. Also, the CAPM results are likely to be similar for companies with similar financial characteristics in the same industry.

Q. WHAT PROBLEMS DO YOU PERCEIVE AS IMPORTANT WHEN USING THE CAPM METHOD?

A. The cost of capital calculations for a company are sensitive to the beta used in the CAPM analysis. This beta is a single measure of risk; consequently, the CAPM will not incorporate any risks not included in the measures of market volatility. Also, a number of analysts have shown that the CAPM overestimates the cost of capital of companies with betas greater than one and underestimates the cost of capital of companies with betas less than one. In regulation, this is important, because most utilities have beta estimates less than one. Another analytical concern, when using the CAPM for determining the cost of common equity, is the overwhelming empirical evidence that it underestimates the cost of capital of smaller companies.

Q. PLEASE EXPLAIN MORE FULLY THE CAPM METHODOLOGY THAT YOU USED IN YOUR ANALYSIS.

A. I applied two complimentary CAPM approaches to estimate the cost of capital of SCE&G. One of these methods examines the historical risk premium of common stock over high grade corporate bonds. The other integrates the risk premium of common stocks to long-term government bonds in recent markets. This second method requires an adjustment for the bias due to company size. The financial literature has recognized this bias

as an empirical problem for a long time, but correcting for this bias is a recent analytical development.

Q. YOU STATED THAT THE FINANCIAL LITERATURE RECOGNIZES THAT THE CAPM METHOD MAY REQUIRE AN ADJUSTMENT FOR A COMPANY'S SIZE. WHAT IS THE NATURE OF THIS RECOGNIZED BIAS?

A. R. W. Banz[7] and M. R. Reinganum[8], in the 1980s, pointed out this size bias. Reinganum examined the relationship between the size of the firm and its price-earnings ratio; he found that small firms experienced average returns greater than those of large firms that had equivalent risk as measured by the beta. Of course, the beta is the distinguishing measure of risk in the CAPM. Banz confirmed that beta does not explain all of the returns associated with smaller companies; hence, the CAPM would understate their costs of common equity. In the same time frame, Fama and French confirmed that the Banz analysis consistently rejected the central CAPM hypothesis that beta sufficed to explain the expected return of investors.[9]

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[7] Banz, R.W., "The Relationship Between Return and Market Value of Common Stock," *Journal of Financial Economics*, March 1981, pp. 3-18.

[8] Reinganum, M. R., "Misspecification of Capital Asset Pricing: Empirical Anomalies Based on Earnings, Yields, and Market Values," *Journal of Financial Economics*, March 1981, pp. 19-46.

[9] Fama, Eugene F., and Kenneth R. French, "The CAPM is Wanted, Dead or Alive," *The Journal of Finance*, Vol. LI, No. 5, pp. 1947-1958.

Q. WHAT DID YOU MEAN WHEN YOU SAID THAT THE CAPM METHOD REQUIRES AN ADJUSTMENT?

A. Although repeated studies showed that the CAPM method possesses a bias that understates the expected returns of small companies, this remained only an empirical observation without a clear remedy. However, Ibbotson Associates, now Morningstar, which is the common source of data for the risk premium used in CAPM analyses, has developed an adjustment for this bias. Morningstar discusses the problem as follows:

> One of the most remarkable discoveries of modern finance is that of the relationship between firm size and return. The relationship cuts across the entire size spectrum but is most evident among smaller companies, which have higher returns on average than larger ones. Many studies have looked at the effect of firm size on return. [10]

To account for this empirical bias against smaller companies, Morningstar has prescribed quantitative adjustments to the CAPM. It publishes this in the same data source used by many analysts to estimate the risk premium in their CAPM analyses.

Q. DID YOU APPLY THE ADJUSTMENT RECOMMENDED BY MORNINGSTAR IN YOUR ANALYSIS?

A. Yes. In my CAPM analysis, I followed the method recommended by Morningstar to compensate for this inherent data bias. Further, I believe

[10] Chapter 7: Firm Size and Return, "Morningstar's Stocks, Bonds, Bills, and Inflation: 2007 Yearbook Valuation Edition," edited by James Harrington, p. 129.

that the adjustment must be made to compensate for the bias and to secure credible results from the CAPM analysis.

Q. DOES THE SIZE BIAS ADJUSTMENT FOR THE CAPM MEASURED BY MORNINGSTAR APPLY TO REGULATED UTILITIES?

A. Yes. Morningstar calculated a measured adjustment specifically for traditional, regulated utilities. In fact, the example calculation by Morningstar used an electric utility to demonstrate the correct manner to apply this adjustment.

Q. TO YOUR KNOWLEDGE, HAVE ANY REGULATORY COMMISSIONS ACCEPTED THIS SIZE ADJUSTMENT TO THE CAPM IN RATE PROCEEDINGS WHEN DETERMINING THE COST OF COMMON EQUITY?

A. I know of at least one instance where a commission recognized the adjustment to the CAPM proposed by Morningstar. The Minnesota Public Utilities Commission has done so in an Interstate Power and Light Company case. The commission observed:

> The Administrative Law Judge takes comfort from the fact that Ibbotson Associates [*now Morningstar*] is a widely-recognized statistical reporting firm that has a national reputation. He considers it to be in the same general category as Standard & Poor's or Moody's. There is no indication that the report in question was prepared for IPL, or the utility industry, to bolster arguments in rate cases. Instead, it appears that the report in question is part of an almanac-type yearbook that Ibbotson prepares without any particular

focus on the utility industry. The Administrative Law Judge understands and shares the concerns of the Staff concerning the methodology used, and thinks the issue is worthy of pursuit in some other forum. But for purposes of this case, the Administrative Law Judge accepts the principal conclusion of the study – that size of a firm is a factor in determining risk and return.[11]

Q. PLEASE DESCRIBE THE RESULTS OF YOUR CAPM ANALYSIS.

A. My two CAPM studies provide complementary results, although they used different data. They serve as benchmarks for the DCF analysis that I had developed previously. For SCANA, the estimated costs of common stock are 11.99 percent and 12.82 percent from these two CAPM analyses. Using these two CAPM methodologies resulted in estimated costs of capital, on average, for the comparable electric utilities in a range from 12.19 percent to 13.07 percent. I show the results of my CAPM analyses in Exhibit No. ____ (DAM-22 and DAM-23).

Q. DID YOU SUMMARIZE THE MORE RELEVANT RESULTS FROM YOUR DCF AND CAPM ANALYSES?

A. Yes. I prepared a summary of the most relevant DCF and CAPM results and illustrated these results in Exhibit No. ____ (DAM-24). For the comparable electric utilities similar to SCE&G, the CAPM results range between 12.19 percent and 13.07 percent, and the DCF results range between 9.22 percent and 11.91 percent.

[11] *In the Matter of the Petition of Interstate Power and Light Company for Authority to Increase its Electric Rates in Minnesota,* Docket No. E-001/GR-03-767, p. 7.

XVIII. RECOMMENDED ALLOWED RETURN

Q. WHAT RETURN ON COMMON EQUITY ARE YOU RECOMMENDING FOR SCE&G IN THIS PROCEEDING?

A. I am recommending an allowed return for SCE&G in the range of 11.75 percent range to 12.00 percent in this proceeding.

Q. WHAT FACTORS DID YOU FIND ESPECIALLY SIGNIFICANT IN REACHING A RECOMMENDED ALLOWED RETURN?

A. Of course, I interpreted the DCF and CAPM results and the current returns on common stock earned by comparable electric utilities. Also the recent and forecasted rising interest rates are the background for setting an allowed return that is sufficient to attract and maintain capital. I evaluated the risk of SCE&G, which is similar to the comparable electric utilities in many respects. However, SCE&G stands out from this group because of the nuclear power plant investment. All of these factors went in to my consideration and judgment in recommending an allowed return in this proceeding.

Q. WHY IS A NUCLEAR POWER PLANT IMPORTANT TO YOUR JUDGMENT ABOUT AN ALLOWED RETURN IN THIS PROCEEDING?

A. Investors will take special note and have concern about the recovery of costs as utilities propose adding nuclear units to their fleet of generating

units. Because nuclear power has not been a technology of choice in the United States for decades, investors will view it as possessing special risks. This will be the case until electric utilities have some success in recovering their nuclear investments. This is the investor risk associated with the recovery of any investment with a technology and construction risk. This was one factor that indicated that the lower market based calculations from the CAPM and DCF results were poor indicators of the appropriate allowed return in this proceeding.

Q. HOW DID THE RESULTS OF YOUR DCF AND CAPM CALCULATIONS AFFECT YOUR RECOMMENDED ALLOWED RETURN IN THIS PROCEEDING?

A. For the comparable electric utilities similar to SCE&G, the results from the CAPM range between 12.19 percent and 13.07 percent. The CAPM is a relatively long-term view of the cost of capital. The highest of these returns, in my judgment is higher than necessary to attract and maintain capital. The average DCF estimate for the comparable companies using securities analysts' forecasts were the most relevant for ratemaking in current markets. These were 10.89 percent and 11.91 percent. The lowest DCF return is insufficient in today's market given the current level of common stock earnings in the industry and the projected rising inflation and interest rates. An allowed return in the center of these calculated returns

is consistent with the level of common stock earnings in the industry and market conditions. The range of 11.75 percent to 12.00 percent is appropriate for setting an allowed return in the forthcoming months.

Q. BASED ON YOUR RECOMMENDED RETURN ON COMMON EQUITY, WHAT IS YOUR RECOMMENDED REQUIRED RETURN ON TOTAL CAPITAL THAT IS APPROPRIATE FOR THIS PROCEEDING?

A. I have calculated the total cost of capital at the lower end of my recommended return on common stock range, or 11.75 percent, to be 9.18 percent. The total cost of capital at the upper end of my recommended return on common stock range, or 12.00 percent, would be 9.31 percent. I have shown the recommended allowed total returns in Exhibit No. ____ (DAM-25).

XIX. INTEREST COVERAGE RATIOS

Q. HOW DID YOU VERIFY THAT YOUR RECOMMENDED ALLOWED RETURN WAS SUFFICIENT TO ATTRACT AND MAINTAIN CAPITAL FOR SCE&G?

A. To verify that my recommended allowed return is sufficient, I compared the After-Tax Interest Coverage ratios for SCE&G at the low end of my recommended allowed return range to the After-Tax Interest

Coverage of the companies comparable to SCE&G. Because the After-Tax Interest Coverage ratio indicates the level of funds available to meet the interest payment obligations of a company's debt component of its permanent capital, this is a measure of the sufficiency of the return. The higher the ratio, the more secure the interest payments.

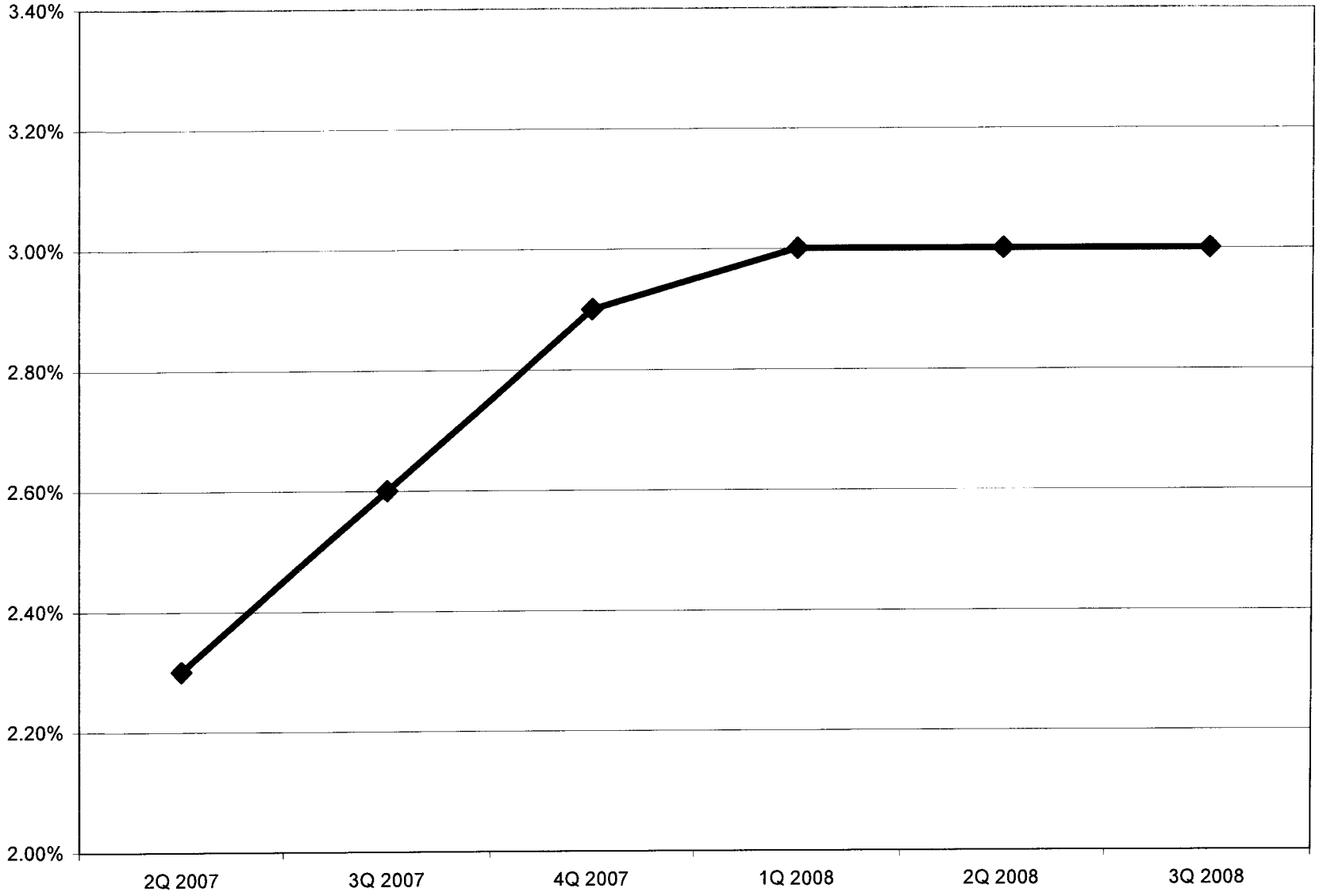
Q. WHAT DID THE AFTER-TAX INTEREST COVERAGE RATIO AT YOUR RECOMMENDED ALLOWED RETURN SHOW?

A. I estimated the After-Tax Interest Coverage of SCE&G at the low end of my recommended return, or 11.75 percent, which is at the upper end of the After-Tax Interest Coverage of my comparable utilities. This coverage is 3.33 times, and in today's market is adequate to attract and maintain capital. I have illustrated the calculation of this After-Tax Interest Coverage for SCE&G in Exhibit No. ____ (DAM-26).

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY AT THIS TIME?

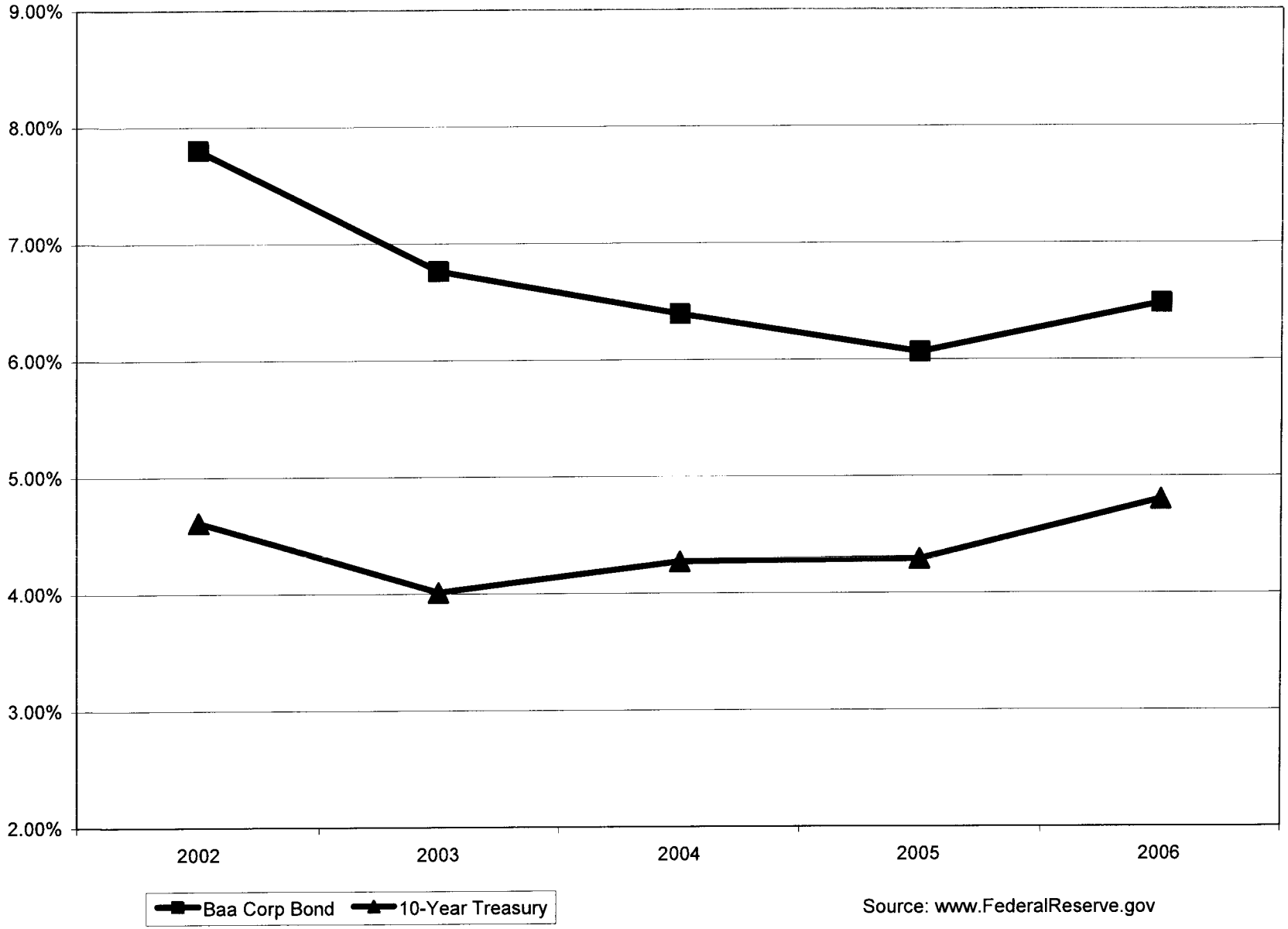
A. Yes, it does.

South Carolina Electric & Gas Company
Real GDP Consensus Forecast



Source: Blue Chip Financial Forecasts, June 1, 2007

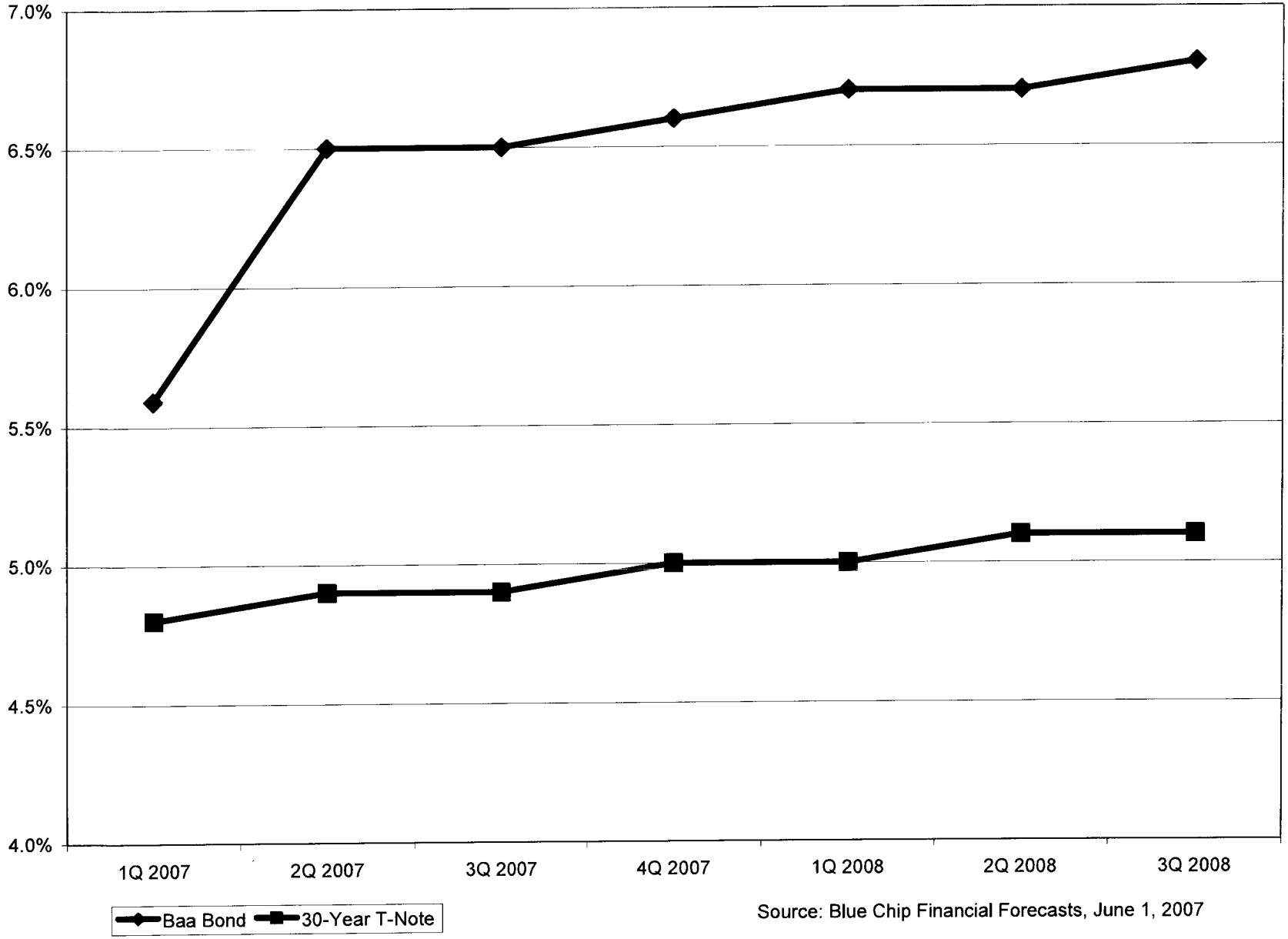
South Carolina Electric & Gas Company
History of Long-Term Bond Interest Rates



Source: www.FederalReserve.gov

Exhibit No.__(DAM-2)
Page 1 of 1

South Carolina Electric & Gas Company
Bond Interest Rate Forecasts



Source: Blue Chip Financial Forecasts, June 1, 2007

Exhibit No.__(DAM-3)
Page 1 of 2

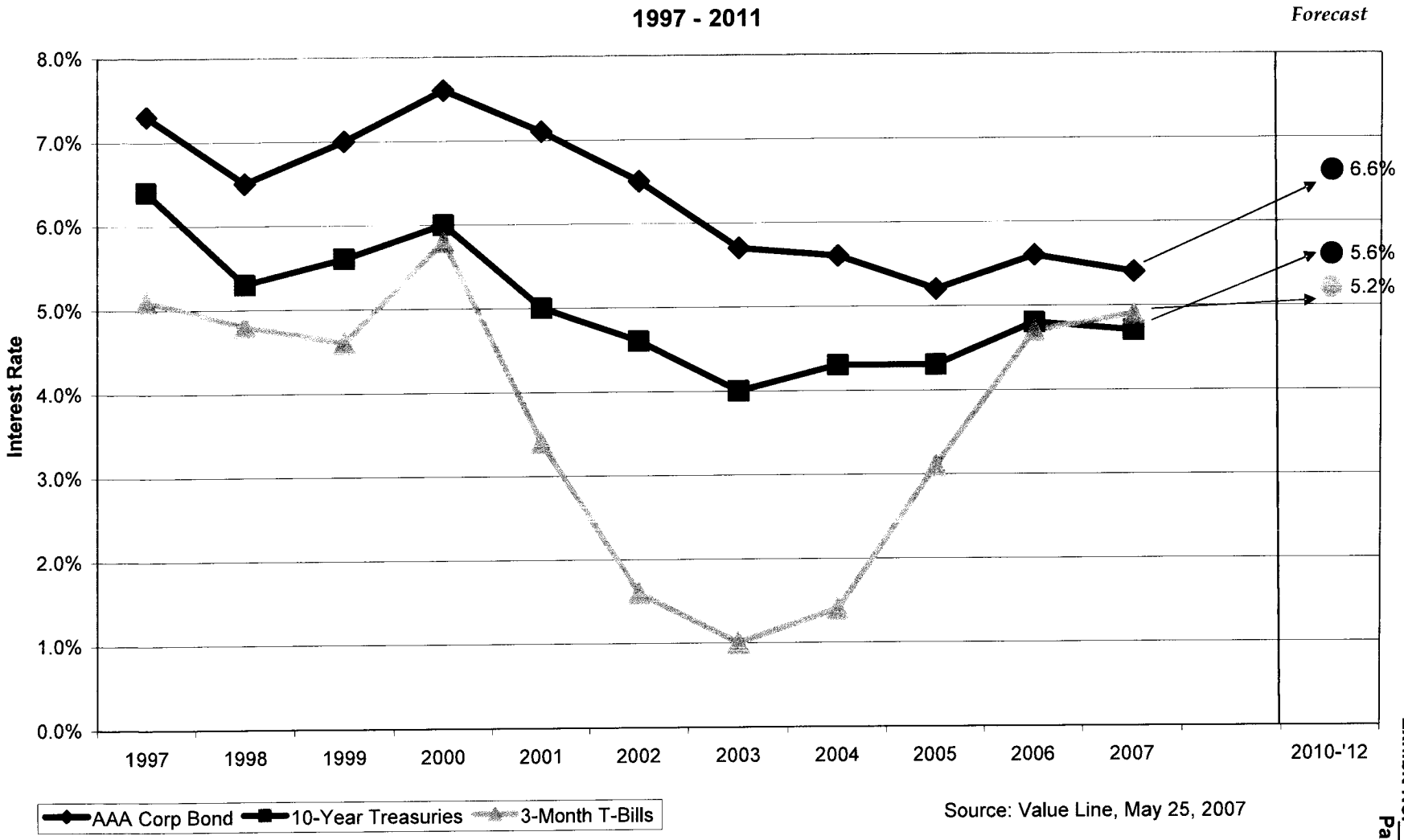
South Carolina Gas & Electric Company

Bond Interest Rate Forecasts

Quarter	Baa Bond	30-Year T-Note
1Q 2007	5.6%	4.8%
2Q 2007	6.5%	4.9%
3Q 2007	6.5%	4.9%
4Q 2007	6.6%	5.0%
1Q 2008	6.7%	5.0%
2Q 2008	6.7%	5.1%
3Q 2008	6.8%	5.1%

Source: Blue Chip Financial Forecasts, June 1, 2007

South Carolina Electric & Gas Company
Value Line Interest Rates and Forecasts
1997 - 2011



Source: Value Line, May 25, 2007

Exhibit No.__(DAM-4)
Page 1 of 2

South Carolina Electric & Gas Company

Comparison of Value Line's Interest Rates

Year	AAA Corp Bond	10-Year Treasuries	3-Month T-Bills
1997	7.3%	6.4%	5.1%
1998	6.5%	5.3%	4.8%
1999	7.0%	5.6%	4.6%
2000	7.6%	6.0%	5.8%
2001	7.1%	5.0%	3.4%
2002	6.5%	4.6%	1.6%
2003	5.7%	4.0%	1.0%
2004	5.6%	4.3%	1.4%
2005	5.2%	4.3%	3.1%
2006	5.6%	4.8%	4.7%
2007	5.4%	4.7%	4.9%
2010-'12	6.6%	5.6%	5.2%

Source: Value Line Investment Survey

South Carolina Electric & Gas Company

Pro-forma Capital Structure

As of March 31, 2007

	Pro Forma Amount	Percent of Total
Long Term Debt	$2,096,488,400	44.26%
Preferred Stock	$114,558,800	2.42%
Common Equity	$2,525,737,686	53.32%
Total	$4,736,784,886	100.00%

Source :
South Carolina Electric & Gas Company Work Papers

South Carolina Electric & Gas Company

Exhibit No.__(DAM-6)
Page 1 of 1

Embedded Cost of Long Term Debt

As of March 31, 2007

	Cost of Money	Amount Outstanding	Annual Cost
First and Refunding Mortgage Bonds:			
9.00% DUE 2006	9.1173%	$0	$0
First Mortgage Bonds			
7.125% Due 2013	7.2474%	$150,000,000	$10,871,100
7.625% Due 2025	7.6749%	$0	$0
6.125 % Due 2009	6.1661%	$100,000,000	$6,166,100
7.5% Due 2005	7.5778%	$0	$0
6.7% Due 2011	6.7606%	$150,000,000	$10,140,900
6.625% Due 2032	6.7378%	$300,000,000	$20,213,400
5.80% Due 2033	5.8703%	$200,000,000	$11,740,600
5.30% Due 2033	5.5820%	$300,000,000	$16,746,000
5.25% Due 2018	5.3795%	$250,000,000	$13,448,750
5.250% Due 2035	5.5012%	$100,000,000	$5,501,200
6.250% Due 2036	5.9061%	$125,000,000	$7,382,625
Pollution Control Bonds			
5.70% Due 2024-Orangeburg	5.7576%	$30,000,000	$1,727,280
4.20% Due 2012-Industrial Rev.	4.3007%	$4,365,000	$187,726
5.20% Due 2027-Industrial Rev.	5.3924%	$56,910,000	$3,068,814
5.45% Due 2032-Industrial Rev.	5.6791%	$29,150,000	$1,655,458
Other Long-Term Debt			
Turbine Spare Parts		$26,063,400	$2,079,859
Stator Bar Parts		$0	$0
Net Amortization of Loss/Gain on Required Debt			$1,934,455
Total		$1,821,488,400	$112,864,267
Weighted Average Cost			$0
6.400% - Prospective First Mortgage Bond Issue	6.460%	$275,000,000	$17,777,650
Total		$2,096,488,400	$130,641,917
Embedded Cost of Long-Term Debt			6.23%

* - Forecast includes prospective First Mortgage Bond issue of $275,000,000 in June 2008.

Source:
Answer No. 8 to ORS First Continuing Audit

South Carolina Electric & Gas Company

Embedded Cost of Preferred Stock

As of March 31, 2007

Series	Cost of Money (%)	Amount Outstanding ($)	Annual Cost ($)
5.00% series	5.1500	6,260,450	322,413
4.50% series	4.6325	252,050	11,676
4.60% series(A)	4.6434	393,900	18,290
5.125% series	5.1992	3,075,800	159,917
4.60% series(B)	4.6592	2,021,850	94,202
6.00% series	6.0428	2,554,750	154,378
6.52% series	6.5859	100,000,000	6,585,900
Total		114,558,800	7,346,776
Embedded Cost of Preferred Stock			6.41%

Source:
Answer No. 11 to ORS First Continuing Audit

South Carolina Electric & Gas Company

Comparable Electric Companies

Comparison of Value Line's Safety and Timeliness Rank

	Safety Rank	Timeliness Rank
SCANA	2	5
DPL, Inc.	3	3
Northeast Utilities	3	3
NSTAR	1	4
OGE Energy	2	4
Pepco Holdings	3	3
Pinnacle West	1	3
Wisconsin Energy	2	5
Comparable Companies' Average	2.1	3.6

Source: Value Line Investment Survey

South Carolina Electric & Gas Company

Comparable Electric Companies

Comparison of Standard and Poor's and Value Line Financial Ratings

Company	Value Line Financial Strength	S&P Rating	S&P Business Position
SCANA	A	A-	4
DPL, Inc.	B	BBB	6
Northeast Utilities	B+	BBB	4
NSTAR	A	A+	1
OGE Energy	A	BBB+	6
Pepco Holdings	B	BBB	5
Pinnacle West	A	BBB-	6
Wisconsin Energy	B++	BBB+	5
Comparable Companies' Median	B++	BBB+	5.0

Sources: Value Line Investment Survey
www.standardandpoors.com

South Carolina Electric & Gas Company

Comparable Electric Companies

Comparison of Returns on Common Equity

	2003	2004	2005	2006	2007E	Five Year Average
SCANA	12.1%	12.2%	11.8%	10.5%	11.0%	11.5%
DPL, Inc.	14.6%	20.7%	11.9%	27.0%	25.5%	19.9%
Northeast Utilities	6.9%	5.1%	5.1%	9.5%	8.5%	7.0%
NSTAR	13.7%	13.1%	12.8%	13.0%	13.5%	13.2%
OGE Energy	11.8%	12.3%	12.1%	14.1%	12.5%	12.6%
Pepco Holdings	7.7%	7.7%	7.7%	7.0%	8.5%	7.7%
Pinnacle West	8.1%	8.0%	6.5%	9.2%	8.5%	8.1%
Wisconsin Energy	11.4%	8.8%	11.3%	10.8%	10.5%	10.6%
Comparable Companies' Averages	10.6%	10.8%	9.6%	12.9%	12.5%	11.3%

Source: Value Line Investment Survey

Exhibit No.__(DAM-10)
Page 1 of 1

South Carolina Electric & Gas Company

Comparable Electric Companies

Comparison of Dividends per Share

Company	2003	2004	2005	2006	2007E	Growth '03-'07
SCANA	1.38	1.46	1.56	1.68	1.76	6.60%
DPL, Inc.	0.94	0.96	0.96	1.00	1.04	2.40%
Northeast Utilities	0.58	0.63	0.68	0.73	0.78	7.66%
NSTAR	1.09	1.13	0.87	1.54	1.33	8.94%
OGE Energy	1.33	1.33	1.33	1.34	1.37	0.62%
Pepco Holdings	1.00	1.00	1.00	1.04	1.08	1.96%
Pinnacle West	1.73	1.83	1.93	2.03	2.13	5.33%
Wisconsin Energy	0.80	0.83	0.88	0.92	1.00	5.61%
Comparable Companies' Averages	1.07	1.10	1.09	1.23	1.25	4.65%

Source: Value Line Investment Survey

South Carolina Electric & Gas Company

Comparable Electric Companies

Comparison of Dividend Payout Ratios

Company	2003	2004	2005	2006	2007E	Five Year Average
SCANA	55%	55%	56%	66%	65%	59.4%
DPL, Inc.	85%	53%	93%	66%	61%	71.6%
Northeast Utilities	48%	70%	72%	48%	55%	58.6%
NSTAR	62%	63%	63%	79%	63%	66.0%
OGE Energy	70%	73%	72%	53%	59%	65.4%
Pepco Holdings	75%	68%	69%	78%	66%	71.2%
Pinnacle West	68%	71%	85%	63%	71%	71.6%
Wisconsin Energy	35%	45%	34%	35%	37%	37.2%
Comparable Companies' Averages	63.3%	63.3%	69.7%	60.3%	58.9%	63.1%

Source: Value Line Investment Survey

Exhibit No.__(DAM-12)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Comparison of Average Annual P/E Ratio

Company	2002	2003	2004	2005	2006	Current
SCANA	12.2	13.0	13.6	14.4	15.4	15.8
DPL, Inc.	28.8	14.5	11.2	26.9	18.0	18.3
Northeast Utilities	16.1	13.4	20.8	19.8	14.2	21.5
NSTAR	12.7	12.7	13.8	15.5	15.9	17.2
OGE Energy	14.1	11.8	14.1	14.9	13.7	16.3
Pepco Holdings	11.3	13.4	13.6	14.9	17.8	16.5
Pinnacle West	14.4	14.0	15.8	19.2	13.7	17.7
Wisconsin Energy	10.5	12.4	17.5	14.5	16.0	19.1
Comparable Companies' Averages	15.4	13.2	15.3	18.0	15.6	18.1

Source: Value Line Investment Survey

Exhibit No.__(DAM-13)
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Stock Price Responses to Positive Dividend and EPS Announcements Greater than Expected
(Cumulative Average Abnormal Returns)

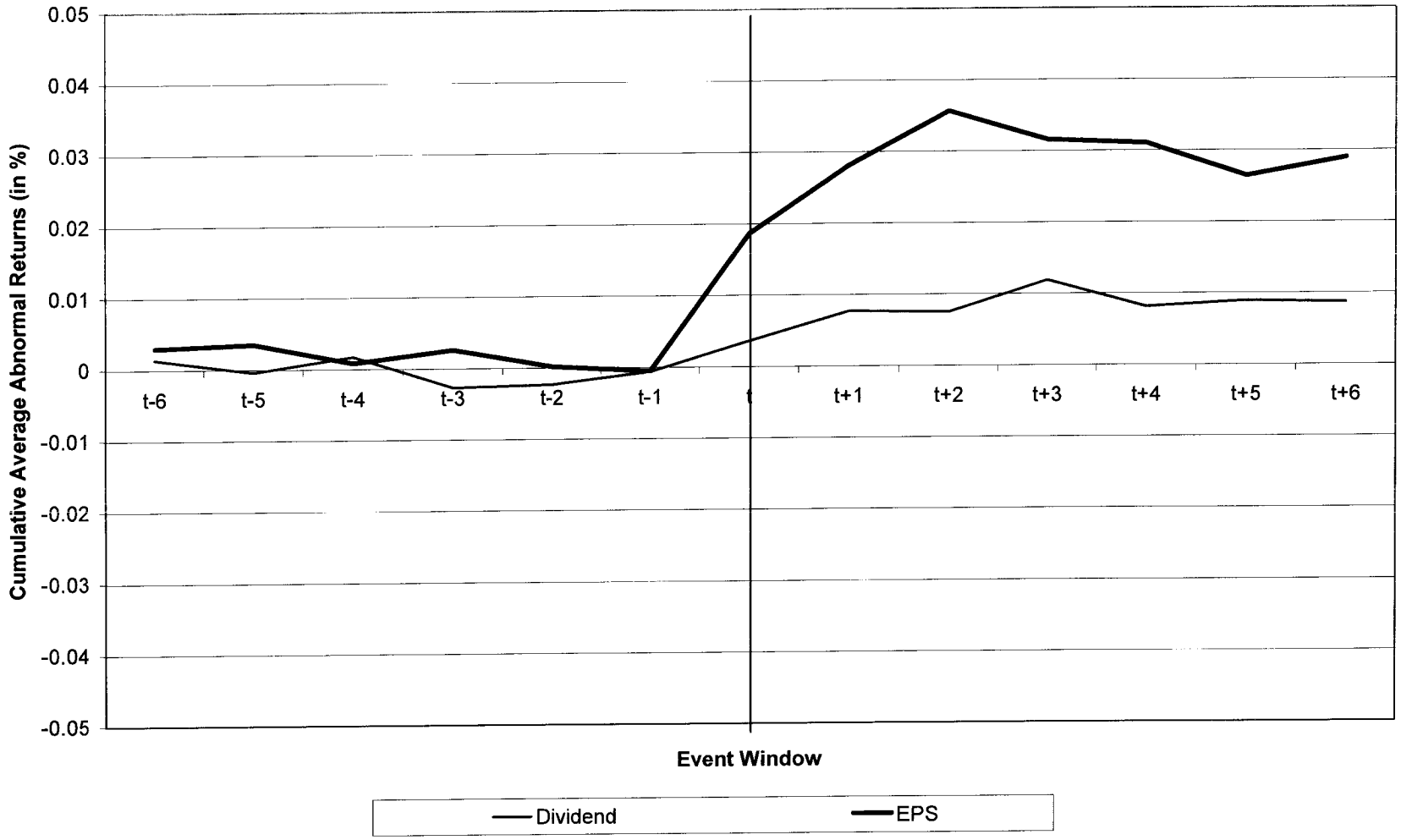

Exhibit No.__(DAM-14)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Discounted Cash Flow Growth Rate Summary

	Value Line 2002 TO 2011 Estimate			Value Line Five Year Historical			Projections Value Line		S & P
	EPS	DPS	Book Value	EPS	DPS	Book Value	EPS	DPS	EPS
SCANA	3.7%	5.0%	4.3%	7.0%	2.0%	3.0%	3.0%	4.5%	5.0%
DPL, Inc.	5.4%	2.8%	4.9%	-1.0%	0.5%	-1.0%	8.0%	7.5%	9.0%
Northeast Utilities	4.0%	7.3%	2.0%	0.0%	30.5%	3.0%	7.5%	6.5%	11.0%
NSTAR	6.6%	5.7%	5.4%	4.0%	1.0%	2.0%	7.5%	8.0%	6.0%
OGE Energy	7.1%	1.7%	6.0%	3.5%	0.0%	3.5%	5.5%	2.5%	4.0%
Pepco Holdings	3.7%	10.9%	2.0%	-1.0%	0.0%	0.5%	8.0%	3.0%	7.0%
Pinnacle West	1.4%	4.7%	2.9%	-5.0%	6.0%	4.0%	3.5%	4.0%	4.0%
Wisconsin Energy	5.6%	5.5%	6.4%	7.5%	-11.0%	5.0%	6.5%	6.5%	8.0%
Comparable Companies' Averages	4.83%	5.51%	4.22%	1.14%	3.86%	2.43%	6.64%	5.43%	7.00%

Sources:
Value Line Investment Survey
Standard & Poor's Earnings Guide

Exhibit No.__(DAM-15)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Projected Growth Rate DCF Using 52-Week Share Prices

	Share Prices		2007	52 Week Yields		EPS Estimates		Cost of Capital	
	Low	High	Dividend	Low	High	Value Line	S&P	Low	High
SCANA	36.92	45.49	1.76	3.87%	4.77%	3.00%	5.00%	6.87%	9.77%
DPL, Inc.	26.11	32.72	1.04	3.18%	3.98%	8.00%	9.00%	11.18%	12.98%
Northeast Utilities	19.49	33.62	0.78	2.32%	4.00%	7.50%	11.00%	9.82%	15.00%
NSTAR	27.12	37.37	1.33	3.56%	4.90%	7.50%	6.00%	9.56%	12.40%
OGE Energy	30.42	41.30	1.37	3.32%	4.50%	5.50%	4.00%	7.32%	10.00%
Pepco Holdings	22.19	30.71	1.08	3.52%	4.87%	8.00%	7.00%	10.52%	12.87%
Pinnacle West	38.63	51.67	2.13	4.12%	5.51%	3.50%	4.00%	7.62%	9.51%
Wisconsin Energy	38.53	50.10	1.00	2.00%	2.60%	6.50%	8.00%	8.50%	10.60%
Comparable Companies' Averages	28.93	39.64	1.25	3.14%	4.34%	6.64%	7.00%	9.22%	11.91%

Sources:
Value Line Investment Survey
Yahoo! FINANCE
Standard & Poor's Earnings Guide

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South Carolina Electric & Gas Company

Comparable Electric Companies

Projected Growth Rate DCF Using Current Share Prices

	Share Prices		Current	Current Yields		EPS Estimates		Cost of Capital	
	Low	High	Dividend	Low	High	Value Line	S&P	Low	High
SCANA	43.20	43.83	1.76	4.02%	4.07%	3.00%	5.00%	7.02%	9.07%
DPL, Inc.	30.72	31.12	1.04	3.34%	3.39%	8.00%	9.00%	11.34%	12.39%
Northeast Utilities	31.80	32.31	0.78	2.41%	2.45%	7.50%	11.00%	9.91%	13.45%
NSTAR	35.93	36.38	1.33	3.66%	3.70%	7.50%	6.00%	9.66%	11.20%
OGE Energy	37.76	38.26	1.37	3.58%	3.63%	5.50%	4.00%	7.58%	9.13%
Pepco Holdings	29.75	30.26	1.08	3.57%	3.63%	8.00%	7.00%	10.57%	11.63%
Pinnacle West	48.60	48.48	2.13	4.39%	4.38%	3.50%	4.00%	7.89%	8.38%
Wisconsin Energy	48.78	49.30	1.00	2.03%	2.05%	6.50%	8.00%	8.53%	10.05%
Comparable Companies' Averages	37.62	38.02	1.25	3.28%	3.32%	6.64%	7.00%	9.35%	10.89%

Sources:
Value Line Investment Survey
Standard & Poor's Earnings Guide
Yahoo! FINANCE

Exhibit No. __(DAM-17)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Dividend Growth Rate DCF Using 52-Week Share Prices

	Share Prices		2007	52 Week Yields		2001-03	2010-12E	Growth	Cost of Capital	
	Low	High	Dividend	Low	High	DPS	DPS	Rate	Low	High
SCANA	36.92	45.49	1.76	3.87%	4.77%	1.29	2.00	4.96%	8.83%	9.73%
DPL, Inc.	26.11	32.72	1.04	3.18%	3.98%	0.94	1.20	2.75%	5.93%	6.73%
Northeast Utilities	19.49	33.62	0.78	2.32%	4.00%	0.52	0.98	7.30%	9.62%	11.30%
NSTAR	27.12	37.37	1.33	3.56%	4.90%	1.07	1.75	5.65%	9.21%	10.56%
OGE Energy	30.42	41.30	1.37	3.32%	4.50%	1.33	1.55	1.72%	5.03%	6.22%
Pepco Holdings	22.19	30.71	1.08	3.52%	4.87%	0.47	1.20	10.89%	14.41%	15.76%
Pinnacle West	38.63	51.67	2.13	4.12%	5.51%	1.63	2.47	4.73%	8.85%	10.24%
Wisconsin Energy	38.53	50.10	1.00	2.00%	2.60%	0.80	1.30	5.54%	7.54%	8.14%
Comparable Companies' Averages	28.93	39.64	1.25	3.14%	4.34%	0.97	1.49	5.51%	8.65%	9.85%

Sources:
Value Line Investment Survey
Yahoo! FINANCE

Exhibit No.__(DAM-18)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Dividend Growth Rate DCF Using Current Share Prices

	Share Prices		Current	Current Yields		2001-03	2010-12E	Growth	Cost of Capital	
	Low	High	Dividend	Low	High	DPS	DPS	Rate	Low	High
SCANA	43.20	43.83	1.76	4.02%	4.07%	1.29	2.00	4.96%	8.98%	9.04%
DPL, Inc.	30.72	31.12	1.04	3.34%	3.39%	0.94	1.20	2.75%	6.09%	6.14%
Northeast Utilities	31.80	32.31	0.78	2.41%	2.45%	0.52	0.98	7.30%	9.71%	9.75%
NSTAR	35.93	36.38	1.33	3.66%	3.70%	1.07	1.75	5.65%	9.31%	9.36%
OGE Energy	37.76	38.26	1.37	3.58%	3.63%	1.33	1.55	1.72%	5.30%	5.34%
Pepco Holdings	29.75	30.26	1.08	3.57%	3.63%	0.47	1.20	10.89%	14.46%	14.52%
Pinnacle West	48.60	48.48	2.13	4.39%	4.38%	1.63	2.47	4.73%	9.12%	9.11%
Wisconsin Energy	48.78	49.30	1.00	2.03%	2.05%	0.80	1.30	5.54%	7.57%	7.59%
Comparable Companies' Averages	37.62	38.02	1.25	3.28%	3.32%	0.97	1.49	5.51%	8.79%	8.83%

Sources:
Value Line Investment Survey
Yahoo! FINANCE

Exhibit No.__(DAM-19)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Earnings Growth Rate DCF Using 52-Week Share Prices

	Share Prices		2007	52 Week Yields		2001-03	2010-12E	Growth	Cost of Capital	
	Low	High	Dividend	Low	High	EPS	EPS	Rate	Low	High
SCANA	36.92	45.49	1.76	3.87%	4.77%	2.34	3.25	3.70%	7.57%	8.47%
DPL, Inc.	26.11	32.72	1.04	3.18%	3.98%	1.18	1.90	5.40%	8.58%	9.39%
Northeast Utilities	19.49	33.62	0.78	2.32%	4.00%	1.23	1.75	4.00%	6.32%	8.00%
NSTAR	27.12	37.37	1.33	3.56%	4.90%	1.69	3.00	6.56%	10.12%	11.46%
OGE Energy	30.42	41.30	1.37	3.32%	4.50%	1.48	2.75	7.10%	10.42%	11.60%
Pepco Holdings	22.19	30.71	1.08	3.52%	4.87%	1.77	2.45	3.70%	7.22%	8.57%
Pinnacle West	38.63	51.67	2.13	4.12%	5.51%	2.91	3.30	1.41%	5.53%	6.92%
Wisconsin Energy	38.53	50.10	1.00	2.00%	2.60%	2.14	3.50	5.62%	7.61%	8.21%
Comparable Companies' Averages	28.93	39.64	1.25	3.14%	4.34%	1.77	2.66	4.83%	7.97%	9.16%

Sources:
Value Line Investment Survey
Yahoo! FINANCE

Exhibit No.__(DAM-20)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Earnings Growth Rate DCF Using Current Share Prices

	Share Prices		Current	Current Yields		2001-03	2010-12E	Growth	Cost of Capital	
	Low	High	Dividend	Low	High	EPS	EPS	Rate	Low	High
SCANA	43.20	43.83	1.76	4.02%	4.07%	2.34	3.25	3.70%	7.72%	7.78%
DPL, Inc.	30.72	31.12	1.04	3.34%	3.39%	1.18	1.90	5.40%	8.74%	8.79%
Northeast Utilities	31.80	32.31	0.78	2.41%	2.45%	1.23	1.75	4.00%	6.41%	6.45%
NSTAR	35.93	36.38	1.33	3.66%	3.70%	1.69	3.00	6.56%	10.22%	10.26%
OGE Energy	37.76	38.26	1.37	3.58%	3.63%	1.48	2.75	7.10%	10.68%	10.73%
Pepco Holdings	29.75	30.26	1.08	3.57%	3.63%	1.77	2.45	3.70%	7.27%	7.33%
Pinnacle West	48.60	48.48	2.13	4.39%	4.38%	2.91	3.30	1.41%	5.80%	5.79%
Wisconsin Energy	48.78	49.30	1.00	2.03%	2.05%	2.14	3.50	5.62%	7.65%	7.67%
Comparable Companies' Averages	37.62	38.02	1.25	3.28%	3.32%	1.77	2.66	4.83%	8.11%	8.15%

Sources:
Value Line Investment Survey
Yahoo! FINANCE

Exhibit No.__(DAM-21)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Size Adjusted Capital Asset Pricing Model

	Risk Free Return	Beta	Equity Risk Premium	Adjusted Equity Risk Premium	Size Premium	Cost of Equity
SCANA	4.98%	0.85	7.10%	6.04%	0.97%	11.99%
DPL, Inc.	4.98%	0.95	7.10%	6.75%	0.97%	12.70%
Northeast Utilities	4.98%	0.90	7.10%	6.39%	0.97%	12.34%
NSTAR	4.98%	0.80	7.10%	5.68%	0.97%	11.63%
OGE Energy	4.98%	0.80	7.10%	5.68%	0.97%	11.63%
Pepco Holdings	4.98%	0.90	7.10%	6.39%	0.97%	12.34%
Pinnacle West	4.98%	1.00	7.10%	7.10%	0.97%	13.05%
Wisconsin Energy	4.98%	0.80	7.10%	5.68%	0.97%	11.63%
Comparable Companies' Average	4.98%	0.88	7.10%	6.24%	0.97%	12.19%

Sources :
Value Line Investment Survey
Ibbotson Associates 2007 SBBI Yearbook: Valuation Edition
Federal Reserve Statistical Release

Exhibit No.__(DAM-22)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Historical Capital Asset Pricing Model

	Market Total Returns	Long-Term Corporate Bonds Return	Risk Premium	Beta	Adjusted Risk Premium	Aaa Corporate Bonds Return	Cost of Equity
SCANA	14.85%	6.20%	8.65%	0.85	7.35%	5.47%	12.82%
DPL, Inc.	14.85%	6.20%	8.65%	0.95	8.22%	5.47%	13.69%
Northeast Utilities	14.85%	6.20%	8.65%	0.90	7.79%	5.47%	13.26%
NSTAR	14.85%	6.20%	8.65%	0.80	6.92%	5.47%	12.39%
OGE Energy	14.85%	6.20%	8.65%	0.80	6.92%	5.47%	12.39%
Pepco Holdings	14.85%	6.20%	8.65%	0.90	7.79%	5.47%	13.26%
Pinnacle West	14.85%	6.20%	8.65%	1.00	8.65%	5.47%	14.12%
Wisconsin Energy	14.85%	6.20%	8.65%	0.80	6.92%	5.47%	12.39%
Comparable Companies' Average	14.85%	6.20%	8.65%	0.88	7.60%	5.47%	13.07%

Sources :
Value Line Investment Survey
Ibbotson Associates 2007 SBBI Yearbook: Valuation Edition
Federal Reserve Statistical Release

Exhibit No.__(DAM-23)
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South Carolina Electric & Gas Company

Comparable Electric Companies

Summary of Financial Analysis

Method	South Carolina Electric & Gas		Comparable Electric Companies	
	Low	High	Low	High
Capital Asset Pricing Model	11.99%	12.82%	12.19%	13.07%
Earnings Growth DCF Analysis	7.57%	8.47%	7.97%	9.16%
Projected Growth DCF Analysis	6.87%	9.77%	9.22%	11.91%

Sources: Schedules DAM-16 through DAM-24

South Carolina Electric & Gas Company

Proposed Cost of Capital

As of March 31, 2007

	Percent of Total	Low	High	Weighted Cost of Capital Low	Weighted Cost of Capital High
Long Term Debt	44.26%	6.23%	6.23%	2.76%	2.76%
Preferred Stock	2.42%	6.41%	6.41%	0.16%	0.16%
Common Equity	53.32%	11.75%	12.00%	6.27%	6.40%
Total Capital	100.00%			9.18%	9.31%

Source:
South Carolina Electric and Gas Company Work Papers

South Carolina Electric & Gas Company

Comparable Electric Companies

Comparison of After-Tax Times Interest Earned Ratios

South Carolina Electric & Gas Company	@11.75% ROE	3.33
	@12.00% ROE	3.38
DPL, Inc.		2.49
Northeast Utilities		1.90
NSTAR		2.58
OGE Energy		3.33
Pepco Holdings		2.25
Pinnacle West		2.50
Wisconsin Energy		2.74
Comparable Companies' Average		2.54

Source : Value Line Investment Survey